



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

201132028

MAY 18 2011

COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Uniform Issue List: 415.12-00

T:EP.RA:G1

Attention:

Legend:

System A =

Plan X =

Excess Plan X =

State N =

State Statute S =

Dear

This is in response to correspondence dated December 29, 2006, as supplemented by correspondence dated November 14, 2007, May 29, 2009, June 23, 2009, October 28, 2009, August 20, 2010, September 29, 2010, February 24, 2011, and March 2, 2011, submitted on behalf of Plan X by its authorized representatives, in which a letter ruling was requested concerning the applicability of section 415(m) of the Internal Revenue Code ("Code") to an excess benefit plan ("Excess Plan X") and the tax consequences related thereto.

The following facts and representations have been submitted under penalty of perjury in support of the rulings requested:

System A is a contributory retirement system in State N which maintains Plan X, a defined benefit retirement plan established pursuant to State N statute for eligible employees of State N and its qualifying governmental units. Your authorized representatives represent that Plan X is intended to be qualified under section 401(a) and is a governmental plan as defined in section 414(d). Plan X is administered by the State N Board of Retirement ("Board").

Plan X includes a mandatory employee contribution feature and certain elective contribution features. Your authorized representatives have represented that the only elective contributions that may be made by participants under the provisions of Plan X are contributions to Plan X to buy years of service credit in Plan X for eligible prior service in other specified public employment. Under the provisions of Plan X, these purchases of years of service credit may only be made by after-tax contributions, rollovers, or trustee-to-trustee transfers.

Your authorized representatives represented in correspondence dated September 29, 2010, that Plan X will be amended to clarify that an employer for purposes of participation in Plan X is limited to entities which are State N, a political subdivision of State N, or an agency or instrumentality of State N. This amendment will also provide that no employer which is not permitted to participate in a qualified governmental pension plan as defined in Code section 401(a) or 414(d) shall be permitted to participate in Plan X.

State N has enacted legislation which authorizes the Board to establish and maintain a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code. In accordance with this legislation, Excess Plan X will be adopted and implemented by State N, as a part of Plan X, effective January 1, 2007.

A separate trust fund for the segregation of the assets of Excess Plan X will be established. This trust fund, which will be separate and apart from the retirement fund of Plan X, will be established solely for the purpose of holding employer contributions intended to pay excess benefits to Plan X participants. The excess benefit trust fund will be designed as a grantor trust for state law and federal income tax purposes. The trustees of this separate trust fund will be the Board.

Article III of Excess Plan X provides that participation is automatic and will commence each plan year once a retired participant or beneficiary has an excess benefit in that plan year. The Board will determine for each plan year which retired participants and beneficiaries are required to participate in Excess Plan X. Participation in Excess Plan X will cease for any portion of a plan year in which the retirement income of a retired participant or beneficiary is not limited by Code section 415(b) or if all benefit obligations under Plan X to the retired participant or beneficiary have been satisfied.

Section 4.01 of Excess Plan X provides that a participant will receive a benefit equal to the amount of retirement income that would have been payable to, or with respect to, a participant by Plan X that could not be paid because of the application of the limitations on his retirement income under section 415(b) of the Code ("excess benefit"). An excess benefit under Excess Plan X will be paid only if and to the extent the participant is receiving retirement benefits under Plan X. Excess Plan X defines "participant" as a retired member or beneficiary who is entitled to benefits under Excess Plan X. The form of the benefit paid to a participant from Excess Plan X will be the same as otherwise selected by the participant and payable under Plan X. The excess benefit to which a participant is entitled under Excess Plan X will be paid commencing during or within the month in which all monthly payments of retirement benefits under Plan X are paid, and the excess benefits will then be paid from that month to the end of the plan year. Under no circumstances will the participant be given any election to defer compensation under Excess Plan X, either directly or indirectly. In addition, there will be no employee contributions to Excess Plan X.

Excess Plan X will be funded on a pay-as-you-go basis. The Board will determine the amount necessary to pay the excess benefits under Excess Plan X for each plan year. The required contribution will be the aggregate of the excess benefits payable to all affected participants for such plan year and an amount determined by the Board to be a necessary and reasonable expense of administering Excess Plan X. The amount so determined will be deposited into the trust fund. Under no circumstances will the contributions to fund the excess benefits under Excess Plan X be credited to the trust established to fund Plan X. Excess Plan X will not accept contributions or transfers from Plan X. Any contributions not used to pay the excess benefits for a current plan year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administration expenses will be used to fund administrative expenses or excess benefits of participants in future plan years.

State Statute S currently provides for a transfer of funds from State N's pension liability fund to Excess Plan X. Your authorized representatives represent that the Board will not implement this provision. Section 5.02(a) of Excess Plan X states that in no event shall a transfer from the pension liabilities fund, as referenced in State Statute S, be made to Excess Plan X. Rather, Excess Plan X will be funded on a pay-as-you-go basis from the State appropriation prior to any deposit into Plan X. Your authorized representatives also represent that System A will seek an amendment to State Statute S which would delete the language regarding transfers from the pension liability fund and add language consistent with the provisions of Excess Plan X.

Although Excess Plan X is a part of Plan X, no assets of Plan X will be used to pay any benefits under Excess Plan X. Excess Plan X is intended to grant a participant no more than a mere contractual right to payment of benefits under Excess Plan X. Employer contributions made to provide benefits under Excess Plan X may not be commingled with assets of Plan X.

Based upon the facts and representations stated above, the following rulings are requested:

1. Excess Plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.
2. The benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.
3. Income accruing to Excess Plan X is exempt from federal income tax under Code sections 115 and 415(m)(1) as income derived from the exercise of an essential governmental function.

Pursuant to correspondence dated May 29, 2009, your authorized representatives withdrew a fourth requested ruling.

Section 415(b) of the Code and section 1.415(b)-1 of the Income Tax Regulations ("regulations") set forth the limitations on annual benefits for participants in defined benefit plans.

Section 1.415(b)-1(b)(1)(ii) of the regulations provides in part that the annual benefit does not include the annual benefit attributable to either employee contributions or rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)), determined pursuant to the rules of paragraph (b)(2) of this section. This section further states that the treatment of transferred benefits is determined under the rules of paragraph (b)(3) of this section.

Section 1.415(b)-1(b)(3)(ii) of the regulations addresses elective transfer of distributable benefits and states in part that the annual benefit provided by the transferee defined benefit plan does not include the annual benefit attributable to the amount transferred.

Section 415(m) of the Code sets forth the treatment of qualified governmental excess benefit arrangements. Section 415(m)(1) provides, in part, that in determining whether a governmental plan (as defined in section 414(d)) meets the requirements of section 415, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account.

Section 415(m)(3) of the Code defines such an arrangement as a portion of a governmental plan which meets the following three requirements: (A) such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by section 415 ("excess benefits"); (B) under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation; and (C) excess benefits are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.

With respect to your first requested ruling, Excess Plan X will be adopted and implemented under the general laws of State N as a part of Plan X. It has been represented that Plan X is a governmental plan as described in section 414(d) of the Code. It has also been represented that the only purpose of Excess Plan X is to provide affected employees of State N and its qualifying governmental units who participate in Plan X that portion of their benefits that would otherwise be payable under the terms of Plan X except for the limitations on benefits imposed by section 415(b) of the Code, as applicable to governmental plans. The terms of Excess Plan X limit participation to participants in Plan X for whom benefits would exceed the limits of section 415 of the Code. Therefore, we have determined that Excess Plan X is a portion of a governmental plan which is maintained solely for the purpose of providing to employees of State N and its qualifying governmental units who participate in Plan X that part of the participants' benefits otherwise payable under the terms of Plan X that exceed the section 415 limits, and, as such, meets the requirements of section 415(m)(3)(A).

Your authorized representatives have stated that participation in Excess Plan X is mandatory and automatic, and that there are no employee contributions to Excess Plan X. Your representatives also assert that no direct or indirect election to defer compensation is provided to any participant in Excess Plan X. Your authorized representatives have represented that the only elective contributions that may be made by participants under the provisions of Plan X are contributions to Plan X to buy years of service credit in Plan X for eligible prior service in other public employment, as described above. Thus, we have determined that no direct or indirect election is provided at any

time to participants to defer compensation, and, accordingly, the requirements of Code section 415(m)(3)(B) are met.

Section 415(m)(3)(C) of the Code requires that the trust from which the excess benefits are paid must not form a part of the governmental plan which contains the excess benefit arrangement, unless such trust is maintained solely for the purpose of providing such benefits. In this case, Excess Plan X will be funded on a pay-as-you-go basis. A separate trust fund for the segregation of the assets related to Excess Plan X will be established. This trust fund will be established solely for the purpose of holding employer contributions intended to pay excess benefits to affected Plan X participants. Contributions to the trust fund will consist only of the amounts required to pay the excess benefits and administrative expenses for the plan year. Any contributions not used to pay the excess benefits for a current plan year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administration expenses will be used to fund administrative expenses or benefits of participants in future years. Therefore, we have determined that the requirements of section 415(m)(3)(C) are met.

Since Excess Plan X satisfies all of the requirements of section 415(m)(3) of the Code, we conclude with respect to your first ruling request that Excess Plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.

With respect to the second requested ruling, section 415(m)(2) of the Code provides that for purposes of this chapter, (A) the taxable year or years for which amounts in respect of a qualified governmental excess benefit arrangement are includible in gross income by a participant, and (B) the treatment of such amounts when so includible by the participant, shall be determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401.

Ruling 1 has already determined that Excess Plan X meets the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements. Accordingly, the tax treatment of the amounts distributed under Excess Plan X to the participants is determined as if such qualified governmental excess benefit arrangement was treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401.

Section 83(a) of the Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount paid (if any) for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Income Tax Regulations (regulations) provides that for purposes of Code section 83, the term "property" includes real and personal property other than money or an unfunded and unsecured promise to pay money or property in the future.

Property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor's creditors, for example, in a trust or escrow account.

Section 402(b) of the Code provides that contributions made by an employer to an employee's trust that is not exempt from tax under section 501(a) are included in the employee's gross income in accordance with section 83, except that the value of the employee's interest in the trust will be substituted for the fair market value of the property in applying section 83. Under section 1.402(b)-1(a)(1) of the regulations, an employer's contributions to a nonexempt employee's trust are included as compensation in the employee's gross income for the taxable year in which the contribution is made, but only to the extent that the employee's interest in such contribution is substantially vested, as defined in the regulations under section 83.

Section 451(a) of the Code and section 1.451-1(a) of the regulations provide that an item of gross income is includible in gross income for the taxable year in which actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting. Under section 1.451-2(a) of the regulations, income is constructively received in the taxable year during which it is credited to a taxpayer's account, set apart, or otherwise made available so that the taxpayer may draw on it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Rev. Rul. 60-31, Situations 1-3, 1960-1 C.B. 174, holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also Rev. Rul. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

Under the economic benefit doctrine, an employee has currently includible income from an economic or financial benefit received as compensation, though not in cash form. Economic benefit applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. Sproull v. Commissioner, 16 T.C. 244 (1951), *aff'd per curiam*, 194 F.2d 541 (6th Cir. 1952), Rev. Rul. 60-31, Situation 4. In Rev. Rul. 72-25, 1972-1 C.B. 127, and Rev. Rul. 68-99, 1968-1 C.B. 193, an employee does not receive income as a result of the employer's purchase of an insurance contract to provide a source of funds for deferred compensation because the insurance contract is the employer's asset, subject to claims of the employer's creditors.

Accordingly, with respect to the second ruling request, we conclude that the benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.

With respect to your third requested ruling, Code section 415(m)(1) provides that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess benefit arrangement will constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) will be exempt from tax under section 115. Ruling 1 has

already determined that Excess Plan X meets the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements.

Accordingly, with respect to your third requested ruling, we conclude that income accruing to Excess Plan X is exempt from federal income tax under Code sections 115 and 415(m)(1) as income derived from the exercise of an essential governmental function.

No opinion is expressed as to the tax treatment of the transactions described herein under the provisions of any other section of either the Code or regulations which may be applicable thereto.

This ruling letter assumes that Plan X is and was a governmental plan as described in section 414(d) of the Code, is and was qualified under section 401(a), and its related trust is and was exempt from tax under section 501(a) at all times relevant thereto.

This ruling letter is based on the assumption that the Board will not implement State Statute S.

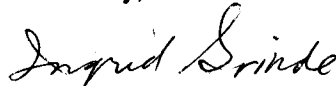
This ruling letter is based on the assumption that the after-tax contributions, rollovers and trustee-to-trustee transfers described above are excluded from the determination of annual benefit within the meaning of section 1.415(b)-1(b)(1)(ii) of the regulations.

This ruling letter is based on the assumption that the revisions described in your authorized representatives' correspondence dated September 29, 2010, will be made.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this ruling letter is being sent to your authorized representatives. If you wish to inquire about this ruling, please contact Please address all
correspondence to SE:T:EP:RA:G1.

Sincerely,



Ingrid Grinde, Manager
Employee Plans Technical Guidance and
Quality Assurance Group 1

Enclosures:

Deleted copy of letter ruling
Notice of Intention to Disclose

cc: